



Economic Update

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HURRICANE EFFECTS ON THE NATIONAL ECONOMY CONTINUE

Overview

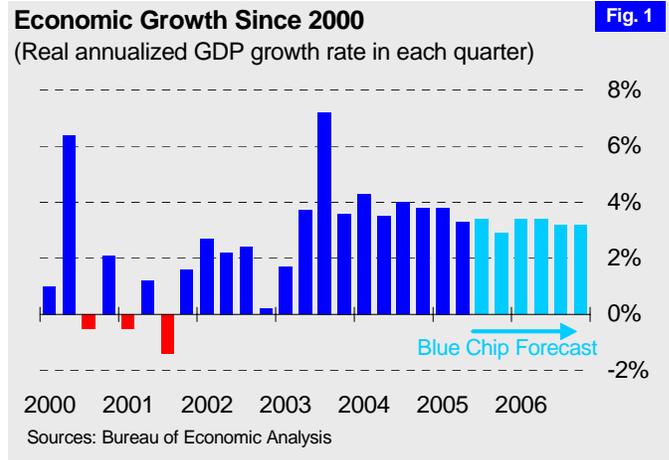
Effects of Hurricanes Katrina and Rita continue to weigh on the U.S. economy, but the overall economic effects appear to be modest thus far. Payroll employment fell in September and the unemployment rate edged up, as expected in light of the storms, but by less than anticipated. Energy prices have eased in recent weeks from the spikes generated by the hurricanes, partly because of reduced U.S. energy demands in the face of elevated prices. Despite the devastation caused by the hurricanes, forecasters anticipate a continuation of healthy economic growth.

Highlights

- The consensus forecast is for 3.4 percent annualized growth in the inflation-adjusted (real) gross domestic product [GDP] in the 3rd quarter, dipping to 2.9 percent in the 4th quarter, and rising to 3.4 percent in each of the first two quarters of 2006 (Fig. 1).
- Payroll employment fell in September by an unexpectedly modest 35,000 jobs (Fig. 2, next page); unemployment edged up to 5.1 percent
- Oil, gasoline, natural gas, and heating oil prices have receded from their post-Katrina peaks, but remain elevated. Natural gas prices have not receded by much. Crude oil has fallen by around 11 percent from the early-September high of nearly \$70 a barrel.

Healthy Growth Expected to Continue

Forecasters continue to see healthy growth and relatively low inflation. The *Blue Chip* consensus forecast is for annualized GDP growth of 3.4 percent in the 3rd quarter (0.5 percentage point below the forecast of early August), and 2.9 percent in the 4th quarter (0.4 percentage point lower than the early-August forecast). Annualized growth in the inflation-adjusted GDP, a broad measure of the Nation's



Blue Chip Economic Outlook, October 2005								
	2005				2006			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	<i>Actual</i>				<i>Projection</i>			
Real GDP Growth	3.8	3.3	3.4	2.9	3.4	3.4	3.2	3.2
Unemployment Rate	5.3	5.1	5.0	5.1	5.0	5.0	5.0	5.0
CPI Inflation	2.5	4.0	4.4	3.5	2.4	2.3	2.3	2.3
3-month Treas. Bill	2.5	2.9	3.4	3.9	4.1	4.2	4.3	4.3
10-year Treas. Note	4.3	4.2	4.2	4.5	4.6	4.8	4.9	4.9

output of goods and services, was a healthy 3.3 percent in the 2nd quarter and a robust 3.8 percent in the 1st quarter.

Growth has been above 3.25 percent in each of the past nine quarters. Growth in the 2nd quarter was led by business investment in equipment and software, exports, residential investment, consumer spending, and government spending. Reduced private inventory investment subtracted 2.14 percentage points from the 2nd quarter change in real GDP.

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Employment Falls, Unemployment Edges Up

Reflecting effects of Hurricane Katrina, payroll employment fell by 35,000 jobs in September. The decline was less than expected, but represents a decrease of roughly 230,000 jobs from the average monthly job gain of the prior 12 months. Hence, the 230,000 jobs is a rough gauge of Katrina's impact on national job growth in September.

Even with the September loss, more than 4.2 million new jobs have been added to payrolls over the past 28 months, and close to 1.6 million have been created this year.

The unemployment rate edged up to 5.1 percent, from 4.9 percent in August, remaining well below the average of each of the past three decades. September's employment and unemployment data do not reflect effects of Hurricane Rita, which struck after the employment surveys were conducted.



CBO Estimates Effects of Hurricanes

The Congressional Budget Office [CBO] estimates that by late this year, GDP growth and employment will return to what the economy would have generated without hurricane effects, and possibly marginally higher as reconstruction takes hold. The hurricanes may reduce GDP growth by 1.0-1.5 percentage points in the 3rd quarter, CBO estimates. Consumer price inflation is expected to accelerate in the 2nd half of this year, partly reflecting higher energy prices. The CBO pointed out that the extent of damages from the hurricanes, and costs of recovery, are still unclear and that "estimates of economic losses and impacts continue to evolve as new data and analysis become available."

Manufacturing Heats Up, Services Cool

The Institute for Supply Management [ISM] index of manufacturing activity unexpectedly jumped in September by 5.9 points, to 59.4. An index value above 50 indicates expansion in the manufacturing sector; 60 indicates a vibrant pace of expansion. The index has been above 50 for 28 consecutive months. The ISM index of non-manufacturing activity fell to 53.3 in September from 65.0 in August, indicating continued expansion in the services sector of the economy, but at a slower pace.

Energy Prices Ease, but Remain Elevated

Futures prices of crude oil have fallen by almost 11 percent since a record high of nearly \$70 a barrel in early September. Gasoline futures prices have also fallen from a record \$2.92 a gallon on August 31. At the pump, regular unleaded gasoline prices averaged \$2.84 across the Nation earlier this week, down from record highs above \$3.00 in early September. Domestic energy demands have subsided recently, and imports of gasoline and other fuels have surged to ease pressures caused by hurricane-related production interruptions. Natural gas and heating oil prices remain elevated, threatening to add to winter heating bills.

Mixed Signals from Housing Markets

New home sales fell 9.9 percent in August from a record-setting pace in July. But existing home sales, which account for 85 percent of all home sales, rose 2.0 percent in August. The national median sales price (half of houses sold for more, half for less) of an existing home hit a record high of \$220,000 in August, up 15.8 percent from a year ago.

Fed Likely to Continue Raising Rates

The Federal Reserve has raised its target overnight interest rate from 1.00 percent to the current 3.75 percent in a sequence of quarter-point increases that began at the end of June 2004. Since May 2004, the Fed has stated that "policy accommodation [keeping rates low to accommodate increased economic growth] can be removed at a pace that is likely to be measured." The "measured pace" language indicates likely further increases in short-term interest rates in the future. The Fed believes that national economic effects of Katrina will be transitory and "do not pose a more persistent threat." The next meeting of the Fed's monetary policy committee is scheduled for November 1.

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